Principal Questions and Answers

Small Meeting for the Financial Year Ending 31 March 2024 (4 June 2024)

Q Although it has become difficult to forecast the outlook for domestic and international interest rates, where do you expect interest rates to head in the future?

A ・It is not impossible to say that the policy rate could rise to 2%, given BOJ Governor Ueda's statement that the neutral rate is 2%. Nevertheless, the Bank's interest rate scenario assumes a policy rate of 0.50% and a long-term interest rate of 1.25% in the first half of FY25. Anything beyond that is difficult to assume, so it has been left aside. Although the outlook for interest rates is difficult to predict, targets such as 8% ROE in the next medium-term management plan ("mid-term plan") are set based on this more likely interest rate scenario.

・In addition, if interest rates rise faster than expected, valuation losses on yen bonds will increase. However, we do not expect valuation losses to be a major problem because we have already significantly reduced our yen bond position, and our yen bond holdings will be redeemed in due course. Loans should be closely monitored for defaults due to the increasing interest rate burden. On the other hand, the rise in interest rates has many positive aspects and has a significant impact on net interest income, including increased carry on yen bonds and higher interest income on loans.

・There is no problem with the dollar, as the loans are mainly at floating rates and the spreads are secured. For foreign bonds, the strategy is to wait for interest rate cuts while preserving a steady interest margin, mainly through Ginnie Mae bonds with some currency-swap funding. The Bank's scenario assumes that the FF rate will reach 3% around FY27 after gradual rate cuts. Interest rate cuts have been slower than expected, but foreign bonds are not at a stage where they will soon be in the reverse margin. If interest rates have not fallen at the time of the currency-swap rollover, another possible treatment would be to sell foreign bonds.

Q The return to positive interest rates will mean a return to an era in which it is possible to increase earnings risk-free. Please tell us whether this will narrow the earnings gap between your bank and other banks that you have been able to differentiate from in the past, or whether your bank will continue to be able to differentiate itself from other banks.

A ・If interest rates return to positive territory, the BOJ's current account and Ministry of Finance loans will enable banks to secure interest margins risk-free. Although that will be an opportunity for banks that have struggled to generate profits due to weak demand for funds, it is hardly an area in which they can differentiate themselves. In order to be valued by investors, the Bank is looking to differentiate itself by establishing separate areas of strength.

・In domestic business, the Bank has an adequate operational base and is chasing leading banks in cross-border loans ("XB") and structured finance ("SF"), on which the Bank is focusing, and is working towards achieving the balance plan set out in the next medium-term management plan. For SMEs, the Bank not only relies on interest income but also promotes the sale of comprehensive consultancy services to improve RORA. The Bank aims to demonstrate its expertise in these growth areas and to differentiate itself from other banks based on such strengths.

Q　The capital allocation shown in the IR seems to result in a shareholder return of more than 50%, but are there any plans to change the return policy in the future?

A　・The Bank's plans show each allocation of profit levels, risk-taking, and shareholder returns so as to achieve a Core CET1 ratio in the range of 10.5% to 11.5% by the end of March 2028. The plan envisages an increase in the core CET1 ratio of 4.4% due to the build-up of profits and a decrease of 2.4% due to shareholder returns, which, as per your question, projects a shareholder return ratio of greater than 50%.

・The Bank is aware of some voices that call for a change in its policy on returns because the Bank's plan shows such a target level. Rather than change the return policy, however, we would first like to make a firm commitment to the profit growth outlined in the plan. We have also developed balance plans to support profit growth on a realistic basis. Neither SME's growth nor a significant increase in XB/SF is a stretch plan. We hope to provide some reassurance by first adhering to the guidance and then increasing returns accordingly. Regarding the shareholder return methodology, we consider the balance between dividends and share buybacks by taking the dividend levels of peer banks and share price performance into account.

Q　The Bank's interest rate scenario seems to assume a policy rate of 0.50% from April 2025. To what extent do you expect profits to increase for the fiscal year ended March 31, 2026, because of the rate hike?

A　・Only deposits and loans are included in the interest rate sensitivity analysis in the Sourcebook. Deposits and loans are expected to show a net gain of 2.8 billion yen. After net interest paid on BOJ borrowings, interest on BOJ current-account deposits is expected to amount to 2.7 billion yen for the fiscal year ended March 31, 2026. With long-term interest rates currently above 1%, the Bank has also started buying yen bonds, albeit in small amounts. If around 100 billion yen can be managed at an average of 1% while building a laddered portfolio going forward, a reasonable increase in profits can be expected.

Q　Do you expect the share of term deposits to increase as in the past when interest rates turn positive? Are you also considering actively promoting term deposits to attract more funds?

A　・Historically, the share of term deposits was high, but the long period of low interest rates has reduced the incentive for term deposits, and the share of savings deposits has been steadily increasing. As interest rates move into positive territory, it will be interesting to see how much savings deposits will be transferred to term deposits, but if the policy rate rises to around 0.50%, there is little incentive, and a significant move would be unlikely. There is some historical data showing a shift towards fixed-rate instruments when the policy rate rises to around 1.0%, but the current diversification of financial instruments makes it difficult to predict whether the trend would be the same as in the past.

・As far as deposit rates are concerned, the interest rate structure and pass-through rates should be set to ensure profitability because branches are operated with infrastructure costs, such as counter operations. Therefore, the Bank does not intend to promote term deposits by competing with other banks on interest rates to increase the balance.

Q What is the strategy to strengthen the profitability of Group companies like Leasing and Securities?

A ・The reality is that neither the leasing nor the securities group companies have made full use of their functions.

・In the leasing business, the company has not been able to offer leasing proposals from the same perspective as loan proposals in response to clients' needs for equipment for new business, environmental initiatives, and labor-saving and productivity-enhancing operations. In fact, Gungin Leasing's outstanding lease balance has hovered around 70–75 billion yen for a long time, and we hope to lift this to 90 billion yen this fiscal year and 110 billion yen in the final fiscal year (ending March 2028) of the next mid-term plan. Given that the Bank has about 1 trillion yen in equipment financing for SMEs, this is not an unreasonable plan. The product range is complete, including car leases that include maintenance and administration, and it is now a matter of ensuring that potential demand is met.

・Regarding the securities business, the Bank, unlike the major players that have a full range of products and services, considers it to be exclusively a retail asset management business based on the Bank's deposits. The Bank considers it important to ensure that clients receive the professional propositions that only a securities firm can offer, rather than to do something special. In the case of banks, proposal quality can vary, depending on the experience of the staff in each branch. Therefore, after clarifying the client segments, the Bank is gradually introducing Gungin Securities to bank clients. While the bank has 5.7 trillion yen in retail deposits, it has about 400 billion yen in mutual funds outstanding, so there is considerable room for making proposals. The Bank intends to strengthen its profitability by meeting the diverse needs of its clients through the practice of asset management-type sales and cooperation between the Bank and its securities arm.

Q Are there any risks in promoting XB/SF, such as narrowing spreads or increased credit risk due to competition?

A ・The target balance for XB/SF to be achieved by the end of March 2028 is 600 billion yen, which is less than 10% of the total lending of 7,410 billion yen. Many major banks and leading regional banks have even higher percentages, so our target is not unreasonable.

・Regarding XBs, the number of deals has been built up by region by spreading across Asia, North America, the Middle East, Europe, and others. Sectors served include financial institutions and oil and resource trading companies. The Bank has expertise in overseas deals, mainly through staff who have worked in the New York office, and has a long track record in dealing with XBs. Most SF's deals take place in the renewable energy, property, infrastructure, and data center sectors, and the company has recently started to work on a wide range of deals, including marine projects.

・The credit quality of customers in both XB and SF is very high and the Bank's internal ratings are generally A3 or higher. Most of them are senior tranche class, including those guaranteed by NEXI (Nippon Export and Investment Insurance) although some such as Vietnam, etc., are rated A4 or lower. The Bank is targeting a RORA of 1.0% on the senior tranche but will also consider working on the mezzanine tranche in the future. In such cases, we also intend to conduct stress tests and manage them prudently with limited exposure. We will increase our headcount to meet our targets and work hard on promotion and risk management.

Q With interest rates in positive territory, will the focus on net interest income lead to a decline in the promotion of non-interest business profit?

A ・Regarding the promotion of non-interest business profit, one of the evaluation items in branch assessments includes a question of whether advisory sales are carried out based on a full-service approach to clients, and front-line staff are aware of the need to promote non-interest business profit.

・The target for non-interest business profit is 32 billion yen for the year ending 31 March 2028. For the current financial year, the Bank is targeting 26 billion yen, and believes that there is ample room for upward movement. As we monitor current progress, we will also consider increasing the target income level.

Q Is there any chance of female employees being appointed as directors in the near future after starting their careers at your bank?

A ・In June this year, the new personnel system was changed to a job-based system of employment. In April, two women were appointed as General Managers in line with the new personnel system. In the past, there were restrictions on holding the position of general manager without certain qualifications, but the new personnel system makes it possible for people in their 40s to be promoted to executive officer positions and the like. Over a period of five to six years, it is possible that the first woman will be appointed as an Executive Officer.

Q Your bank seems to be planning to increase lending to SMEs in the Keihin region. How much are you planning to invest?

A ・The network of branch offices in the Keihin area is already very well developed. In terms of human resources, a structure has been put in place for both promotion and management, with five additional Liaison Officers and six Loan Officers deployed in April. However, they have been instructed not to promote it excessively, and will be, for example, increasing the balances of projects with large lot sizes. Because in the past we have had bitter experiences in the Keihin region when credit costs increased after a significant increase in loan balances, we prioritize increasing the number of loan staff and improving the credit management system before stepping up promotional activities.

Q With corporate deposits on the rise, do you have incentives in place to encourage them?

A ・In the profitability assessment sheets that banks use, a settlement rate is set for deposits, and the difference between the deposit interest rate and the settlement rate is returned and assessed as income in accordance with earned deposits.

・Deposits were not sufficiently promoted to key clients in the past, but the balance of corporate deposits has increased owing to increased deposit initiatives in line with the proportion of loans. After a long period of lending-focused promotion, we want to make people aware that both deposits and lending are important, and we will work toward attracting and increasing deposits in the future.

Q Now that your bank's share price has risen significantly, are you going to continue to consider buying back shares?

A ・Given that the Bank's P/B ratio has not yet reached 1x and is theoretically undervalued, share buybacks should be considered in a flexible manner. The Bank regards share buybacks as an effective way to return profits to shareholders, as they also have the effect of boosting the share price. That said, it is also important to balance this with dividends. EPS has increased every year, and we would consider increasing the dividend accordingly.

Thank you.